See Vol. 3476

JUN 2. 1969

Nos. 22397 - 22398A

In The

United States Court of Appeals

For the Ninth Circuit

FILED

JUN 18 1969

WM. B. LUCK, CLERK

No. 22397

UNITED STATES OF AMERICA,

Appellant,

vs.

CALIFORNIA PORTLAND CEMENT COMPANY, a corporation, Successor-in-Interest to ARIZONA PORTLAND CEMENT COMPANY, a corporation,

Appellee.

No. 22397-A

CALIFORNIA PORTLAND CEMENT COMPANY, a corporation, Successor-in-Interest to ARIZONA PORTLAND CEMENT COMPANY, a corporation,

Cross-Appellee.

vs.

UNITED STATES OF AMERICA,

Cross-Appellant.

No. 22398

UNITED STATES OF AMERICA,

Appellant,

vs.

CALIFORNIA PORTLAND CEMENT COMPANY,

Appellee.

No. 22398-A

CALIFORNIA PORTLAND CEMENT COMPANY,

Cross-Appellant,

vs.

UNITED STATES OF AMERICA,

Cross-Appellee.

CALIFORNIA PORTLAND'S PETITION FOR REHEARING

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Pursuant to Rule 40, FEDERAL RULES OF APPELLATE PROCEDURE, petitioner respectfully requests a rehearing of this Court's decision entered June 4, 1969, for the following reasons:

I. THE COURT'S RELIANCE ON A NEW REGULATION OF RESPONDENT, PROMULGATED WHILE THE CASE WAS ON APPEAL, APPEARS MANIFESTLY INEQUITABLE TO PETITIONER AND TO ESTABLISH A VERY UNDESIRABLE PRECEDENT.

We believe that the basis for the Court's opinion on the bagging question presents an important issue of judicial procedure. For many years, the pertinent regulation has been Section 39.23(m)-1(e) of Treasury Regulations 118 (herein called "Regulation 118").[1] This regulation survived several reenactments of the statute, was made applicable to the 1954 Code by respondent,[2] and was regarded as not being changed by both the Treasury and Congress in the 1960 formulation of the statutory "kiln-feed" cut-off point applicable here.[3] At all times prior to and including the briefing

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1. Regulation 118, made applicable to the 1954 Code by T.D. 6091, 1954-2 C.B. 47, is substantially identical to the first regulations adopted under the 1939 Code--Reg. 103, § 19.23(m)-1(e) and, thereafter, Reg. 111, § 29.23(m)-1(e).

2. Ftn. 1, supra.

3. Hearings Before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes, 86th Cong., 1st Sess. p. 47 (March 5, 1959).

of this appeal, both parties treated said regulation as controlling,[4] and it was the basis for the District Court's decision in favor of petitioners. On July 26, 1968, however, 17 months after the District Court's decision adverse to it,[5] the Government superseded said Regulation 118 by a new regulation (Reg. § 1.613-3) which specifically adopted the result it had attempted and failed to obtain in the District Court. Moreover, respondent's new regulation stated that it was retroactively applicable for the proceeding 15 years.[6]

In our respectful opinion, it is not consistent with the essential justice of the judicial system to allow a litigant, once it has lost a case in the trial court, to promulgate new rules in its favor which control the appeal. The role of courts is to apply law to facts, and this process cannot function in a meaningful manner if one side has the power to change the rules in mid-stream.

This court believed the new regulation could be given retroactive application because of Dixon v.

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4. See, e.g., the Government's opening brief on appeal, p. 18.
"The specific methods by which 'gross income from mining' shall be computed are set forth in the long-standing provisions of Section 39.23(m)-1(e)(3) of Treasury Regulations 118 (1939 Code)."

5. Filed February 27, 1967. No. 22397, I-R. 117.

6. To taxable years beginning after December 31, 1953.

United States, 381 U.S. 68 (1965); Pollack v. Commissioner, 392 F.2d 409 (5th Cir. 1968); and United States v. Fenix & Scisson, Inc., 360 F.2d 260 (10th Cir. 1966). None of these cases, however, involved circumstances with any parallel to the present case.

In Dixon, the Government retroactively withdrew its acquiescence to a Tax Court decision. It specifically excepted from retroactive effect, however, the period between the announcement of its acquiescence and the withdrawal. 381 U.S. at 72. In Pollack, the court's main emphasis was on the express language of the statute, but it did state that a regulation could be retroactively applied where no prior regulation had existed. In Fenix, there also was no prior regulation, and there was an earlier revenue ruling which was nearly identical to the new regulation.

It would appear that the discretion of the Government to apply rulings or regulations retroactively should vary substantially, depending on the factual circumstances. Thus, for example, it should have more freedom with respect to retroactivity where a ruling or acquiescence is involved, or where a new regulation does not supersede a prior, valid regulation of long standing. The authorities establish this view.

In International Bus. Mach. Corp. v. United States, 343 F.2d 914 (Ct. Cl. 1965), the court held that the Government's discretion, provided in 26 U.S.C. § 7805(b), to determine the retroactive effect of new rulings or regulations was not unlimited. There, a ruling applied retroactively to I.B.M. denied it a prior year excise tax exemption which had been allowed to Remington Rand. The court held that retroactive effect would not be permitted and stated:

> "Implicit, too, in the Congressional award of discretion to the Service, through Section 7805 (b), is the power as well as the obligation to consider the circumstances surrounding the handing down of the ruling--including the comparative or differential effect on the other taxpayers in the same class. . . . Equality of treatment is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed.
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> " . . . [T]he Commissioner's exercise of discretion is reviewable . . . for abuse, in the same way as other discretionary administrative determinations. The Internal Revenue Service does not have carte blanche. Its choice must be a rational one, supported by relevant considerations." 343 F.2d at 920. (emphasis added)

To date, the proper treatment of bagging has been judicially considered in more than 8 cases, and all have applied Regulation 118. United States v. Ideal Basic Industries, 404 F.2d 122 (10th Cir. 1968), cert. denied. ___U.S.___, (1969) was litigated slightly

ahead of the instant case, and the Tenth Circuit's decision (issued August 15, 1968) reached the same result as the District Court below and the majority of the other decisions deciding the bagging issue under Regulation 118. It is apparent, therefore, that retroactive application of the new regulation to petitioner does not give it equality of treatment with other taxpayers in the same class. In addition, the "equality of treatment . . . dominant in our understanding of justice" must mean that one litigant cannot have the power to retroactively apply new rules to its litigation while on appeal.

The Court states (Op. 4) that the new regulations "have the force and effect of law." If this is true of the new regulation, it certainly must be true of the superseded regulation which, prior to supersession, was in effect for many years and survived several re-enactments of the statute. Clearly the Treasury, however, as an administrative tribunal, has no power to retroactively change prior law.

The Government's power to retroactively amend a prior, valid regulation of long standing was considered by the Supreme Court in Helvering v. R. J. Reynolds Tobacco Co., 306 U.S. 110 (1938). In holding that,

under the substantially similar predecessor to § 7805(b), the Treasury could not retroactively amend its long-standing regulations, the court stated:

> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rules of law that existed during the period for which the tax is imposed." 306 U.S. at 116.

Similarly, in Broadcasting Publications, Inc. v. District of Columbia, 313 F.2d 554, (D.C. Cir. 1962), the court held:

> "Where valid regulations are in force at the operative date of the tax, new or amended regulations are not to be given retroactive effect." 313 F.2d at 556.

No case has been found which involved the extreme facts of a prior valid regulation of long standing and relied on by a lower court being superseded by a new regulation on appeal, months after the lower court's decision. In less extreme circumstances, however, the Sixth Circuit in Commissioner v. Goodwyn Crockery Co., 315 F.2d 110, 113 (6th Cir. 1963), refused to consider as binding a new regulation promulgated after the lower court's decision.

For the above reasons, we respectfully submit that no weight whatever should have been given to the Government's last minute new regulation, and that the

case should have been judged exclusively on the regulation applicable at the time of the District Court's decision. In this regard, we shall not repeat the discussion of bagging at pp. 30-35 of our opening brief, except to emphasize:

(i) Regulation 118 specifically states that the computation must work back from "the first marketable product."

(ii) The District Court found as a fact that bulk and not bagged cement was the first marketable product.

(iii) As stated by the Ideal court:

"Equally compelling is the simple logic that bulk cement is the first marketable product, bagged cement is the second marketable product. . . . " 404 F.2d at 126.

(iv) To supersede "the first marketable product" with the "group of products" concept introduced in the new regulation, results in two constructive depletable prices for a single fungible product--kiln feed.

(v) The weight of authority on the point supports the District Court. This court thought certain cases pertaining to nonintegrated miners were distinguishable. All the cases cited involved the same question, however--determination of the

first marketable product. Once such determination was made, the nonintegrated cases directly applied the depletion percentage, while the integrated cases then had to use this starting point to work back under the proportionate profits formula.

(vi) The Government's petition to the United States Supreme Court for certiorari in the most recent case favoring petitioner--Ideal Basic Industries, supra--was denied on June 2, 1969.

II. THE DISTRICT COURT'S FINDINGS ON THE CASH DISCOUNTS ISSUE WERE NOT CLEARLY ERRONEOUS.

The District Court found that petitioner's discounts were offered for the purpose of inducing prompt payment of its invoices and not to induce sales of its cement, and that these were cash discounts rather than trade discounts.[7] These findings were supported by substantial evidence[8] and, therefore, were required to stand unless clearly erroneous. FED. RUL. CIV. PROC. 52(a); Bloom v. United States, 272 F.2d 215 (9th Cir. 1959).

In apparently holding that the findings were clearly erroneous, this court made the following points:

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7. F.F. 13

8. Pltf. Ex. 20 B-C, 232-37, 388; Pltf. Ex. 24, p. 4.

(i) In Southwestern Portland Cement Co. v. United States, 22 AFTR 2d 5874, 5877 (C.D. Cal. 1968), that District Court held similar discounts to be trade discounts.

(ii) The discount did not represent a fair interest rate.

(iii) The discount was rarely disallowed.

(iv) The discount was prevalent in the industry.

Southwestern Portland involved key subsidiary findings not present here:

> "The discounted price was offered to customers primarily to encourage purchases in competitive situations. . . . and was not a device to obtain prompt payment from customers. . . . "/9

In the present case, the uncontroverted testimony was that the purpose of petitioner's discounts was to induce collection of its accounts./10 Moreover, it does not appear that petitioner should be bound by findings of fact in a case in which it was not a party. The Government, however, has been a party to three other cases (two involving the Southern California market)

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9. F.F. 23 and 25.

10. E.g., Pltf. Ex. 20-B, 222, 235.

in which similar discounts were held to be cash rather than trade discounts.[11]

The question of a fair interest rate has appeared in the Government's Rev. Rul. 60-257, 1960-2 C.B. 197 (not applicable to taxable years ending prior to January 1, 1960) and Rev. Rul. 55-13, 1955-1 C.B. 285. At most, this factor would appear only of evidentiary value on the question whether the purpose of the discounts was to induce payment or to induce product sales. This court, reviewing the voluminous record, concluded that petitioner's discount, amounting to about 5-1/2% of sales, "was allowed for prepayment of anywhere between 1 and 20 days."[12] Actually, accounts were considered discounted if paid by the 10th of the month following billing and delinquent if not paid by the end of said month.[13] Accordingly, the pre-payment period was at least 20 days, and longer where a customer did not wait until the last minute to take the discount.

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11. California Portland Cement Co. v. Riddell, 59-1 U.S.T.C. para. 9156 (F.F. 14) (S.D. Cal. 1958), rev'd. on other grounds, Riddell v. California Portland Cement Co., 297 F.2d 345 (9th Cir. 1962); Riverside Cement Co. v. United States, 58-2 U.S.T.C. para. 9905 (F.F. 8) (S.D. Cal. 1958); Standard Lime & Cement Co. v. United States, 329 F.2d 939 (Ct. Cl. 1964).

12. Op. 20.

13. Pltf. Ex. 20-D 470.

Petitioner's discount was approximately 2-1/2 times the "2% 10th day, net 30 days" terms common throughout many vendor industries. There are numerous small purchasers in the construction industry, however, many of whom are not good credit risks. Accordingly, the size of petitioner's discount, in this industry context, is entirely consistent with petitioner's stated purpose to use its discount to effect collection of its accounts./14 Obviously, where the discount is of sufficient size to be meaningful, it will be an inducement for customer payment ahead of other suppliers, and petitioner's bad debts experience was extremely low./15

The court also thought the fact that petitioner's discounts were rarely disallowed was indicative of a trade discount, allowable in all events. The only direct testimony, however, was that the discount was used and was effective to induce payment. It certainly had this effect, because approximately 95% of petitioner's accounts were paid by the end of the month following billing./16 There would have been no reason for such rapid payment if plaintiff's customers had viewed the discount as a mere price making device.

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14. N. 10, supra.

15. Pltf. Ex. 20-D at 234.

16. Pltf. Ex. 20-B, 234.

The court's final point was that the discount was prevalent in the industry. We respectfully submit that this should not be material, because an industry could have a uniform credit policy, as well as a price policy. Thus, for example, if all suppliers had followed a "2% 10, net 30" policy, the fact of a cash discount would have been unquestioned.

The Government's principal evidence was the theorizing of an accounting professor, who admitted his familiarity with the cement industry was limited to prior testimony in two cases as a paid witness for the Government.[17] In contrast, petitioner's witnesses were experts in the industry, and their testimony was supported by the objective fact of petitioner's excellent collection experience, as well as judicial findings in two earlier cases involving the same market area. In these circumstances, we submit that the District Court's findings should not be held to be clearly erroneous.

Respectfully submitted,

DATED: June 17, 1969

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17. Pltf. Ex. 20-A, 9, 18-19, 23.

I am one of counsel for petitioners herein and I certify that in my judgment this petition is well founded and it is not interposed for delay.

Peter C. Bradford